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FISCAL IMPACT STATEMENT

LS 7562 | **NOTE PREPARED:** Apr 14, 2011
BILL NUMBER: SB 589 | **BILL AMENDED:** Apr 13, 2011

SUBJECT: Economic Development and State Tax Matters.

FIRST AUTHOR: Sen. Hershman | **BILL STATUS:** CR Adopted - 2nd House
FIRST SPONSOR: Rep. Turner

FUNDS AFFECTED: X GENERAL | **IMPACT:** State & Local
X DEDICATED
FEDERAL

Summary of Legislation: (Amended) *Interim Study Committee on Economic Development:* The bill makes the Economic Development Study Committee a four-year committee that expires December 31, 2014, and provides for certain studies.

IEDC Reports and Studies: The bill requires the Indiana Economic Development Corporation (IEDC) to collaborate with local economic development organizations and submit an annual report to the study committee regarding collaboration. It requires the IEDC to conduct a statewide study to determine specific economic sectors that should be emphasized by the state and by local economic development organizations within geographic regions in Indiana.

Entrepreneurship Education Programs: The bill requires the State Board of Education, the Commission for Higher Education, and the Department of Workforce Development to work together to develop entrepreneurship education programs for elementary and secondary education, higher education, and individuals in the work force.

Technology and Innovation Commercialization Programs: The bill requires higher education institutions to expand technology and innovation commercialization programs.

Corporate Income Tax Reduction: The bill decreases the Corporate Adjusted Gross Income Tax rate from 8.5% to 6.5% over four years beginning in 2013.

Exclusion of Interest on State and Local Bonds: The bill provides that the Adjusted Gross Income Tax and Financial Institutions Tax (for credit unions and investment companies) apply to interest on state and local bonds that are issued by a state other than Indiana or issued by a political subdivision of such a state and purchased after December 31, 2012.

Net Operating Loss (NOL) Carryback: The bill eliminates the carry back of net operating losses under the adjusted gross income tax.

Attribution of Business Income to Indiana: The bill revises the attribution rules applicable to business income and sales receipts from certain intangibles under the Adjusted Gross Income Tax.

Sales Tax Exemption for Utility Expenditures: The bill provides that a claim for a sales tax refund must be filed within 18 months if the claim is based on the predominant use of electrical energy, natural or artificial gas, water, steam, and steam heat by certain businesses or based on the sales tax exemption for these services or commodities.

Regional Development Authorities: The bill provides that in the case of a county that becomes a member of a regional development authority (other than the Northwest Indiana Regional Development Authority) after June 30, 2011, and before July 1, 2013, the county may impose an additional county economic development income tax at a rate of 0.025% (rather than 0.05%, under current law).

Tobacco Tax on Moist Snuff: The bill provides that the Tobacco Products Tax on moist snuff is based on the weight of the moist snuff and calculated at the rate of $0.38 per ounce.

Provisional Property Tax Statements: The bill allows counties that are more than two years behind on issuing tax bills to petition the Department of Local Government Finance to postpone the deadline for paying the first installment on a 2011 provisional property tax statement.

Other: The bill prohibits the Department of State Revenue from taking an action to collect a protested listed tax until the later of the time to file a tax appeal has expired or a final decision is made in a tax appeal. The bill requires a study of ways to reduce fraud and abuse of the Indiana earned income tax credit and all aspects of phasing out the state inheritance tax.

Effective Date: (Amended) Upon passage; January 1, 2011 (retroactive); July 1, 2011; January 1, 2012; January 1, 2013.

Explanation of State Expenditures: (Revised) *Interim Study Committee on Economic Development:* The bill establishes the Interim Study Committee on Economic Development for four years until the end of 2014. The Committee will consist of 17 members as follows: two Senators, two Representatives, the CEO of the Indiana Economic Development Corporation (IEDC) or the CEO's designee, four members appointed by the Governor, four members appointed by the President Pro Tempore of the Senate, and four members appointed by the Speaker of the House of Representatives. During the 2010 interim, the Legislative Council provided $16,500 budgets for interim study committees with 16 or more members, including for the Interim Study Committee on Economic Development which was structured the same as in this bill. The Committee held two meetings in Indianapolis, one meeting in Anderson, and one meeting in West Lafayette at a total cost of $6,355.

The Committee is to operate under the policies governing study committees adopted by the Legislative Council. The Committee must issue a final report before November 1st each year to the Legislative Council containing any findings and recommendations of the Committee.

IEDC Reports and Studies: The bill requires the IEDC to collaborate with local economic development organizations and submit an annual report to the Interim Study Committee on Economic Development concerning collaborative efforts. The IEDC is also required to conduct a statewide study to determine economic sectors that should be emphasized within geographic regions in Indiana. These provisions may increase expenses for the IEDC, but should be able to be accomplished within the IEDC's existing resources.

Entrepreneurship Education Programs: The bill requires the State Board of Education, the Commission for Higher Education (CHE), and the Department of Workforce Development to develop entrepreneurship education programs for elementary and secondary education, higher education, and individuals in the work force. This provision should be able to be accomplished within the existing resources available to the State Board of Education, the CHE and the DWD.

Technology and Innovation Commercialization Programs: This bill requires higher education institutions to expand technology and innovation commercialization programs. State educational institutions may need to reallocate resources from other programs or areas to meet this requirement.

(Revised) *Department of State Revenue (DOR)* The DOR will incur additional expenses to revise tax forms, instructions, and computer programs to reflect the changes made by the bill. The bill also requires the DOR to study the ways to detect and eliminate fraud and abuse of the Earned Income Tax Credit, and to submit a report of its findings to the Legislative Council before October 1, 2011. The DOR's current level of resources should be sufficient to implement these changes.

(Revised) *Inheritance Tax Study:* The bill requires the Commission on State Tax and Financing Policy to study phasing out the Inheritance Tax. The bill requires the Commission to report its findings to the Legislative Council before November 1, 2011. There would be no additional expense unless the Commission met an additional time in order to include this topic of study.

Explanation of State Revenues: (Revised) *Corporate Tax and State and Local Bond Interest Exclusion Changes:* The bill: (1) reduces the Corporate Adjusted Gross Income (AGI) Tax rate from 8.5% to 6.5% in 0.5% increments over four years beginning in 2013; and (2) eliminates the exclusion for individual and corporate taxpayers for interest income from state and local bonds (other than Indiana state and local bonds) initially purchased by the taxpayer after December 31, 2012. The table below reports the net impact on state revenue from these changes.

	Net Impact (in millions)				
Provision	**FY 2013**	**FY 2014**	**FY 2015**	**FY 2016**	**FY 2017**
Corporate AGI Tax Rate Reduction	(9.2)	(28.2)	(48.4)	(69.8)	(81.4)
Elimination of Interest Exclusion	0.0	12.8	26.1	39.9	54.1
Total	**(9.2)**	**(15.4)**	**(22.3)**	**(29.9)**	**(27.3)**

The corporate AGI Tax rate reduction would be phased in as specified in the table below.

Tax Year	Corp. AGI Tax Rate
2012	8.5%
2013	8.0%
2014	7.5%
2015	7.0%
2016 and after	6.5%

Revenue from the corporate AGI Tax is distributed to the state General Fund. The revenue loss estimate is based on the Revenue Technical Committee forecast (April 15, 2011) for the corporate AGI tax. Since the rate reduction begins in 2013, the revenue loss is estimated to begin in FY 2013 as corporate taxpayers change their quarterly estimated payments.

The elimination of the exclusion of interest income from state and local bonds (except those issued by Indiana or Indiana local governments) would affect revenue from: (1) the individual AGI tax; (2) the corporate AGI tax; (3) and the Financial Institutions Tax (FIT) as it applies to credit unions and investment companies. (Note: Under current statute, financial institutions other than credit unions and investment companies pay FIT on interest from state and local bonds, including Indiana state and local bonds.) Since this is effective beginning with bonds initially purchased by the taxpayer after December 31, 2012, the revenue gain is estimated to begin in FY 2014 and would not affect all interest earnings on state and local bonds. The estimated revenue gain is based on the percentage of total state and local debt each year that is attributable to debt issued during that year beginning with 2013. Newly issued debt would, by definition, meet the initial purchase requirement. The revenue gain would be higher to the extent that debt issued prior to 2013 might otherwise be purchased initially by a taxpayer in 2013 or after, for instance, by purchase of shares in a bond or other investment fund.

(Revised) *Net Operating Loss (NOL) Carryback:* The bill eliminates carry back of NOL by individual and corporate taxpayers beginning in tax year 2013. This change could potentially reduce carry back usage in the long run by business taxpayers, provided they are not able to deduct as much NOL over time without carry back. More likely, this change will not increase the amount of income tax paid in the long run by businesses with NOL, since NOL not deducted in the year it is incurred could still be carried forward for 20 years. However, eliminating carry back of NOL would prevent business taxpayers from using NOL incurred during recessionary periods to obtain immediate refunds by amending returns and deducting these NOL amounts against tax liabilities for the year or two immediately preceding the recession.

Current statute allows a business that pays the corporate adjusted gross income tax or the individual AGI tax to deduct from AGI the net operating loss the business incurs during the taxable year. If the business's AGI during the taxable year is not sufficient to deduct all the NOL, the business may: (1) carry back the excess NOL and deduct it from the business's AGI during the two preceding taxable years; or (2) carry forward the excess NOL and deduct it from the business's AGI during subsequent tax years for up to 20 years.

While data is available showing the amount of NOL claimed annually by individual and corporate taxpayers, the amount of NOL carried back cannot be distinguished. From 2000 to 2008: (1) NOL deductions by individual taxpayers ranged from $202.6 M in 2006 to $432.5 M in 2008; and (2) NOL deductions by corporate taxpayers ranged from $655.0 M in 2001 to $9,688.6 M in 2006.

(Revised) *Attribution of Business Income to Indiana:* The bill clarifies the attribution rules applicable to business income and sales receipts from certain intangibles under the adjusted gross income tax in lieu of current statute that provides specific conditions under which income and receipts from intangible property are attributable to Indiana. The provision responds to the Tax Court's decision in Riverboat Development, Inc. v. Indiana Department of State Revenue (Cause No. 49T10-0506-TA-52), February 22, 2008. In this case, the Tax Court decided that income received by a by a non-Indiana pass through entity from its interest in an Indiana pass through entity is, under current statute, not taxable income for purposes of the adjusted gross income tax. Under the provision, it is expected that income in such circumstances would be attributable to Indiana and taxable under the adjusted gross income tax. This provision could potentially prevent additional revenue loss under current income attribution rules. The amount of revenue loss that might be prevented is indeterminable.

(Revised) *Sales Tax Exemption for Utility Expenditures*: Under current statute, transactions involving electrical energy, natural or artificial gas, water, steam and steam heat are exempt from Sales Tax if the person acquiring the energy uses it in the direct production of goods. The bill provides that a refund claim based on this exemption may not cover transactions that occur more than 18 months before the date of the refund claim. By restricting the time period that refunds could be claimed, this bill could potentially result in an indeterminable decrease in the amount of Sales Tax refunds claimed. Any impact however is expected to be minimal.

(Revised) *Tobacco Tax on Moist Snuff:* This bill could have an indeterminable impact on Tobacco Products Tax revenue. Under current statute, all tobacco products are taxed at a rate of 24% of the wholesale price. The bill provides that the Tobacco Products Tax imposed on the distribution of moist snuff is based on the net weight of the moist snuff and calculated at a rate of $0.38 per ounce. All other tobacco products other than moist snuff will continue to be taxed at 24%.

The existing tax on snuff is based on the value of snuff. The amount of revenue collected depends on the changes in quantity sold and the price. This bill proposes a tax that is based only on the quantity sold; all moist snuff products would be taxed equally based on weight without regard to price. As a result, the incidence of tax would shift from higher-priced moist snuff to lower-priced snuff.

Of the Tobacco Products Tax revenue, 25% is distributed to the Affordable Housing and Community Development Fund. The remaining revenues are allocated to Medicaid reimbursements (2.46%), Cigarette Tax Fund (4.22%), the Mental Health Centers Fund (0.6%), the state General Fund (54.5%), the Pension Relief Fund (5.43%), the State Retiree Health Benefit Trust Fund (5.74%), and the Check-Up Plan Trust Fund (27.05%).

Explanation of Local Expenditures: (Revised) *Provisional Property Tax Statements:* Under current law, property taxes that are billed on a provisional tax statement are due in two installments, on May 10th and November 10th. This bill would permit a county treasurer in a county that is more than two years behind in billing to petition the DLGF to extend the deadline for the first 2011 installment to as late as July 1, 2011. LaPorte County is the only county that is more than two years behind in billing. The extended due date, if granted, would mean that civil taxing units and school corporations would wait longer for their spring tax distribution. Some units might have to borrow additional money for operating purposes in anticipation of their tax distributions. Any additional borrowing would increase interest expense.

Explanation of Local Revenues: (Revised) *Exclusion of Interest on State and Local Bonds:* Eliminating the exclusion for interest income from state and local bonds (except those issued by Indiana or Indiana local government) would significantly increase taxable income. Consequently, some counties imposing local option income taxes could potentially experience a substantial increase in revenue from these taxes. Based on the current average LOIT rate of about 1.3%, LOIT collections on a statewide basis could potentially be increased as specified in the table below. The distribution of this revenue gain across counties is unknown, however.

State Fiscal Year	Revenue (in millions)
2014	$2.6
2015	5.4
2016	8.5
2017	11.8

(Revised) *Regional Development Authorities:* The bill provides that counties or municipalities forming regional development authorities during FY 2012 and FY 2013 will receive transfers equal to the amount that would be distributed from a CEDIT rate of 0.025%. Current statute provides that members of regional development authorities will receive transfers equal to the amount that would be distributed from a CEDIT rate of 0.05%. The bill also provides for an additional CEDIT rate of 0.025% for such counties.

Currently, the Northwest Indiana Regional Development Authority is the only regional development authority in Indiana.

State Agencies Affected: DOR; IEDC; State Board of Education; CHE; DWD; State educational institutions.

Local Agencies Affected: Counties with local option income taxes. Counties and second class cities establishing regional development authorities. Delaware County CREDs.

Information Sources: OFMA Income Tax databases, 2000-2008. Revenue Technical Committee Forecast, April 15, 2011. Gruber, J. and Rauh, J. (2007). *How elastic is the corporate income tax base?* Bruce, D., Deskins, J., and Fox. W. (2005) *On the Extent, Growth, and Efficiency Consequences of State Business Tax Planning*. Bruce, D. Deskins, J., and Fox, W. (2006). *On The Relative Distortions of State Sales, Corporate Income and Personal Income Taxes*.U. S. Census Bureau, *State and Local Government Finances* databases, 1998-2008. U. S. Internal Revenue Service, Statistics of Income Division, *Annual Analysis of Individual Income Tax Returns*, *SOI Bulletins*, Fall 2002-Fall 2010. U. S. Congress, Joint Committee on Taxation, Annual *Estimates of Federal Tax Expenditures* reports, 2008-2010. U. S. Internal Revenue Service, Statistics of Income Division, Annual Corporate and Individual Tax Stats Tables. Tom Conley; DOR; 317-232-8039.

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